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In the Supreme Court of the United States

OCTOBER TERM 1972

No. 72-810

R. L. GRAVES, FLORA J. GRAVES,
R. L. and FLORA J. GRAVES, and
SPARKS NUGGET, INC. as TRANSFEREE,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE.

Petitioners' Reply to the Brief in Opposition

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On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

Petitioners' Reply to the Brief in Opposition

ARGUMENT

1. Because the substantiality of the conflict between the decision below and that in *Rubin v. CIR,* (C.A. 2, 1970) 429 F.2d 650, is important, we must inform the Court that respondent's statement (Brief in Opposition, pages 7-8) that "On remand, the Tax Court reached the same result under Section 482 as it had reached under Section 61" is false.

The true state of affairs is that described by the Court of Appeals for the Second Circuit, which said that on remand (*Rubin v. C.I.R.*, (C.A.2, 1972) 460 F.2d 1216, 1217-18): "Acting under Section 482, the [tax] court *substantially*

reduced the amounts of additional income and consequent deficiences." (Emphasis ours.)

The actual figures are set forth in Footnotes 1 and 2 at 460 F.2d 1216, 1217-18. They also may be found by comparing 51 T.C. 251 with 56 T.C. 1155, where the first and second Tax Court opinions are reported. The net amounts allocated to the shareholder-employee in the first Tax Court decision were $8,085.09 for the first year, and $42,781.33 for the second year (51 T.C. at 264), and on remand these amounts were reduced to $4,400.00 and $23,500.00, respectively (56 T.C. at 1164). The deficiencies first determined were $5,872.00 for 1960 and $25,304.00 for 1961. "[T]he deficiencies were reduced to $3,917.42 and $13,315.42" (460 F.2d at 1218 fn.2). The reduction in the deficiency for 1960 was 49.9 per cent of the final deficiency and for 1961 the final deficiency was reduced to 52.6 per cent of the original one. The reduction in the deficiency for 1961 nearly equalled the final deficiency for that year, being 90 per cent of it.

Accordingly, the reconsideration under Section 482 on remand was not an idle gesture, and it is not true that the Tax Court "reached the same result" on remand as it had in the original decision, because on remand the Tax Court "substantially reduced" the deficiencies.

2. Since we are filing a reply, we shall mention three other points where our answers might be self-evident.

a. At page 5 of the Brief in Opposition, respondent says that "The test [of the constructive dividend] is whether there is a diminution in the earnings and profits of a corporation which inures to the benefit of a stockholder." To hold that test satisfied here is to permit respondent to lift himself by his own bootstraps. As this transaction was framed by the parties, there was not an over-all diminution of earnings and profits, because the diminution of those of The Challenger was equalled by increases in earnings and

profits of the lessor corporations. If Section 482 were held applicable, those earnings and profits adjustments would be reversed and The Challenger would not have a diminution.

However, under the decision below, the reduction in earnings and profits of The Challenger has occurred because of the payment of the rentals held excessive. The disallowance of the deduction for the rentals, without more, restored the earnings and profits in The Challenger and they would not be reduced if the constructive dividend were not found.

Thus, respondent seems to lift himself by his own bootstraps.

b. Respondent seeks to avoid the conflict between the decision below and *Rubin* by claiming that Section 61 and Section 162 are not parallel because Section 61 is broader in scope than Section 162. In that event, Section 61 is a more suitable section to duplicate Section 482 than is the more narrowly confined section involved here. Respondent's point merely means that compared to *Rubin*, the present case is a fortiori from the *Rubin* result, and this is precisely what we said in our petition. Hence, respondent's analysis emphasizes the conflict.

c. Respondent's reply to the assertion of a conflict with *Holsey v. Commissioner*, (C.A. 3, 1958) 258 F.2d 865, is confined to a footnote (Brief in Opposition, page 7, fn.2), and perhaps the resultant brevity is what has produced the inaccuracies. Contrary to what is said there, there was *not* the certainty that Holsey would ever have gains to be taxed, if he was held to have none in the transaction involved. There was nothing in the facts to suggest that he meant to sell any of his stock and indeed the implication of the facts was to the contrary: the transaction was framed to avoid his having to receive dividends in order to pay off a debt incurred to buy the stock redeemed by his corporation, the payment of real dividends was made more remote by the

transaction. The fact is that these were the incidents of the transaction which caused the Tax Court to hold it taxable, a decision reversed on appeal.

Again contrary to what respondent's footnote claims, the Graves had less "immediate benefit" than Holsey. Their wealth was not increased by having Sparks Development pay off the bank loan instead of The Challenger's doing so, because in either event the bank debt of a wholly owned corporation was reduced in the same amount, and in the cases of the other corporations there were no debts to be paid until they built the casino building to rent to The Challenger,[1] and the same point about the immateriality to the Graves' wealth of which of their corporations paid off the mortgage note is true there.

In each case, there would be no tax unless there was a later sale, but to Holsey, unlike Graves, there was an immediate tax benefit in the form of the transaction, and Holsey won. In deciding that the Graves should not, the court below decided the case in conflict with *Holsey*, and inevitably in a manner to rekindle fires of litigation thought dead.

CONCLUSION

The writ of certiorari should issue.

Respectfully submitted,

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1. The deductibility of this rent is not in question.